The Institute of International and European Affairs

What China has to Offer Europe

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China's View of Europe

"… even if the debt crisis had not happened and the EU had not sought Chinese help, China would never stop demanding that the EU abandon its obsolete mentality and take a more open-minded approach on issues of currency disputes, high-tech export restrictions, arms sales embargo and human rights censure". *(NCNA 2/11/11)*

China's Global Growth

	1978	2010
Share of world GDP	2%	9%
Share of world exports	1%	10%
World trade ranking	29th	2nd

Global Partnerships

- Global integration makes the PRC (total GDP USD6 tn) a close "partner" of the US and EU (total GDP USD16 tn each).
- PRC export interests mean that it cannot ignore other nations in setting its own exchange rate.
- The PRC cannot avoid using the largest financial markets (New York, London).

Global Financial Giant

- PRC foreign exchange reserves have been world's largest since 2006:

  2011: US$3.1tn; 2007: US$1.5 tn .
- China's target is to abolish exchange controls by 2015.
- General expectation is for a freely convertible RMB to overtake the USD and the Euro.

Why Exchange Controls Remain

- They protect the exchange rate and financial institutions against instability during economic and political crises.
- They allow the state to fix the exchange rate to suit China's national interests.
- They protect PRC banking from more efficient, foreign competitors.

The Current Case for Caution

- “Correlation between [bank] efficiency and profitability is close to zero” in China (except in Hong Kong). (IMF 2009)
- "Borrowing [in 2009] by 1000s of companies set up by China’s local governments to fund construction is the nation’s equivalent of the US subprime mortgage crisis". Cheng Siwei, former V-chair NPCSC (*CD* 17/09/11))
- Wenzhou “where BMWs, Ferraris or Lamborghinis and self-made millionaires abound”, more than 90 tycoons have "disappeared, committed suicide or declared bankruptcy”, leaving behind personal debts of USD1.6 bn. (*CD* 16/11/10; *NCNA* 25/10/11)

Global Crisis, Collateral Damage

- 2008-09: US$586 bn economic stimulus package, 70% funded by LG bank loans, with immediate "systemic risks" to the financial system. (BoC, *NCNA 9/11/09*))
- Solutions have been hampered by conflicting data about even the number of "financial vehicles".
  - NAO estimate is 6,576 LGFVs.
  - PBOC estimate is 10,000+ LGFVs.
  - CBRC estimate is 9,000+ LGFVs. (NCNA 11/07/11)

Future Pressures

- National plan to increase the housing stock by 20% by 2015
  - Targets are for 36 mn new units, 4 mn to be completed 2011
  - Funding: USD766 bn, mainly from LGs
- NB: In 2011 PBOC "reclassified" 1/3rd (USD438 bn) of 2009 LG bank borrowings to ease strains on bank reserves. (*CD* 15/08/11)

Why Liberalise the RMB

- To create a fully competitive banking and financial system and halt below-cost funding
- To shift exchange risks and transactions costs to foreign investors and traders
- To end export-led growth based on low-wage/low-tech products dominated by "foreign-invested" firms which currently account for 50% of exports

Preparing for the Globalised RMB

- A convertible RMB will lead to diversification of China's foreign exchange portfolio.
- Its management will be market-driven instead of PBOC, SAFE or CIC administered.
- The Eurozone's current attraction is that assets are plainly undervalued.
- Rebalancing from USD means a shift to Euro.
- The policy question: will the Euro retain its surprising strength against the USD?

The US Benchmark

- In 2009, New York securities industry profits were US$61 bn, highest ever.
- In 2008-09, FRBNY invested US$45 bn in Citigroup, from which a profit of US$12bn+ has already been made.
- In 2008-09, $700 bn spent on TARP [Troubled Asset Relief Programme] lifeline. Repaid by end-2010

Globalising the RMB via Hong Kong

- 71 of the world's 100 largest banks
- 1st for IPOs (equity raised)
- 7th by market cap (2nd in Asia)
- 7th in forex trading
- 4th FDI inflows (2nd in Asia)
- 1st FDI outflows to China (1979-10)
- 1993-10: 595 Mainland IPOs (US$384 bn)

Hong Kong Banking: Crisis-proof

Hong Kong imposes direct constraints on banks' mortgage business to ensure loans are affordable:

- 1991: mortgage loan-to-value ratio for mortgages set at 70%
- 1994-98: property exposure ceiling of 40% on a bank's total Hong Kong loans
- 2011: loan-to-value ratio for mortgages further reduced to halt incipient bubble

For full data and sources, see:

- *Reluctant Regulators: How the West Created and China Survived the Global Financial Crisis* (2011)
- *Uneasy Partners: The Conflict between Public Interest and Private Profit in Hong Kong* (2nd edition 2009; Chinese edition 2011)